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SUBJECT: CAMBODIA'S ECONOMIC SLOWDOWN: AN OPPORTUNITY FOR

REFORM

SENSITIVE BUT UNCLASSIFIED

11. (SBU) Summary: Prime Minister Hun Sen announced to an assembled audience of the country's top economists and development partners at the Third Cambodia Economic Forum February 5 that projections for Cambodia's economic have been revised downward to 6 percent for 2009, indicating the more sober attitude the government has toward the increasing threats to Cambodia's economic growth. The PM described policy measures and reforms to mitigate the negative impacts of the economic slowdown. However, economists predict a sharper decline in growth for 2009, and structural and regulatory reforms are essential in promoting growth and improving Cambodia's competitiveness in the short and long term. The government's political will and commitment to reform will be sorely tested in the trying times to come. End Summary.

Remarkable Growth Comes to an End  
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12. (U) Over the past decade, Cambodia has enjoyed an average 9.8 percent annual economic growth, ranking it the seventh fastest growing economy in the world. However, according to a recent World Bank study, the special factors that gave rise to this decade of rapid economic growth, are no longer present. Economists at the forum agreed that the especially rapid growth Cambodia enjoyed early in the decade was unsustainable in the medium term, and in fact growth began to slow in 2006. Discounting the fact that Cambodia was starting from a very low base, high growth was primarily due to preferential market access and expanding trade due to regional integration.

13. (U) The current external environment adds additional challenges to sustaining economic growth. In the first half of 2008, Cambodia was hit with high inflation, and in the second, the global economic crisis hit key sectors of Cambodia's economy. The garment industry, which makes up roughly 31 percent of Cambodia's GDP and is one of the pillars of the Cambodian economy, is estimated to have declined by 2 percent in 2008. Experts predict a much sharper decline in 2009 as orders from the U.S. dry up. The tourism sector, which grew by nearly 20 percent in 2007, is also showing signs of decline. Its growth slowed to an estimated 8 percent in 2008; tourist arrivals fell by 3.3 percent. Tour operators report hotel occupancy declined by up to 30 percent during the December 08-February 09 "high season." Construction has also slowed due to the real estate slowdown and over-supply, and experts predict it will take five years to recover. A significant deceleration in growth is expected in all three of these key sectors in 2009.

14. (SBU) With these bleak figures in mind, the PM conceded

that the RGC has revised its forecast for economic growth from 7 percent down to 6 percent for 2009. (Note: As recently as the previous week, the PM was publicly maintaining that growth would reach 7 percent. The World Bank and IMF have predicted growth rates to fall below 5 percent. End Note.) The PM then outlined proposed measures to mitigate the effects of the decline in Cambodia's economy, including structural and regulatory reform to improve the business environment, investment in infrastructure, and provision of social safety nets.

#### Agriculture to the Rescue

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15. (SBU) In particular, the PM highlighted the important role that the agriculture sector could play in diversifying Cambodia's economic base and offsetting the slowing growth in other key sectors. He emphasized the need to increase agriculture production, value-added processing, and exports, and called for greater investment in infrastructure, such as irrigation. The RGC plans to make credit available to rice farmers, millers, and exporters through loans from Cambodia's Rural Development Bank. The PM expressed his hope that investment in the agriculture sector, which currently accounts for 30 percent of GDP, could help to boost output and sustain economic growth. (Comment: Additionally, growth and diversification of the agriculture sector could also help to mitigate the adverse social consequences of slowing economic growth by increasing rural incomes, enhancing food security, and absorbing laid-off workers. However, falling commodity prices may discourage some farmers from expanding production. End Comment.)

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16. (U) In the garment sector, the PM acknowledged the need for regulatory reforms to reduce the cost of doing business, including removing barriers to commerce (such as non-transparent fees, customs procedures, and licensing requirements). He also stated that human resource development is key to increasing Cambodia's competitiveness in the long term. The PM proposed the creation of training scholarships to improve skills as well as providing a social safety net for laid-off workers. He also appealed for improved industrial relations to reduce the number of labor disputes plaguing the garment industry. The PM also discussed the tourism sector, pledging to continue to provide a favorable political/security environment to attract tourists. He also stressed the need for greater public-private partnerships to strengthen the sector, and encouraged the private sector to reduce costs and improve the quality of services provided.

#### Structural Reforms Needed

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17. (SBU) Panelists encouraged the RGC to ease fiscal policy and urged the government to redouble its revenue collection efforts, including non-tax revenue from various line ministries. On the monetary side, while the banking sector remains liquid, experts warned that the sector is vulnerable to significant risks: an over concentration of the sector in a few banks, overly strong links to the volatile real estate sector, and poor classification of credit. Experts urged the RGC to maintain a flexible exchange rate and to increase supervision of the growing banking sector.

18. (SBU) At several times during the conference, the RGC appealed to development partners for additional assistance to support its policy measures and proposed reforms. Panelists repeatedly stressed the need to accelerate disbursement of funding and timely implementation of assistance programs to promote growth and mitigate the negative impacts of Cambodia's economic slowdown. However, some participants stressed that structural reforms are essential to making Cambodia a more attractive destination for additional foreign

assistance and foreign direct investment.

Comment

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¶9. (SBU) The RGC is taking the challenges to its competitiveness and continued growth seriously. Its revised growth forecast from 7 percent to 6 percent, however, is still overly optimistic. The IMF's prediction of growth below 4.8 percent is more realistic (and is tolerably good, compared to many economies in the region.) However, the challenges of the global economic crisis present Cambodia with an opportunity to make important structural and regulatory reforms needed to create a more favorable business environment and facilitate trade, enhancing Cambodia's competitiveness in the short and long term. The past decade of economic growth is not sustainable without potentially painful and politically difficult reforms. The reforms and policy measures proposed by Hun Sen and elaborated by the RGC officials at the economic forum could help Cambodia to weather the current economic storm and realign the economy from its overly narrow base, wean it of its dependence on garment exports, and position Cambodia well for another period of sustained growth when the global economy rebounds.

¶10. (SBU) Opposition politician Sam Rainsy criticized the RGC's proposed measures as paying lip service to the donors and for failing to address the real challenge to greater economic growth in Cambodia: corruption. The lack of transparency within the government and also in its dealings with the private sector is often cited as a significant constraint to further growth. While Hun Sen may have sincerely pledged his government to reform, the exclusion of opposition members of parliament from the invitation-only economic forum sent a somewhat contradictory message about the government's commitment to a path of open, transparent governance.

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